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AgLetter

FARMLAND VALUES AND CREDIT CONDITIONS

Our quarterly survey of over 350 agricultural bankers indicated that farmland values were unchanged during the second quarter in the Seventh Federal Reserve District. Weakness in farmland markets in Iowa and Illinois offset gains in the other three District states. However, farmland values were still 8 percent above the year-earlier level as of July 1. In addition, the demand for new farm loans remained firm throughout most of the District in the second quarter, although some weakening was noted in Indiana. Loan repayment rates slowed relative to the previous year, and the bankers noted increased activity by their competitors.

The second-quarter movement in farmland values was somewhat mixed among the five District states. Michigan and Wisconsin each registered a gain of two percent, while Indiana showed a slim rise of one percent. Farmland values in Illinois held steady in the second quarter, and a 1-percent decline was reported by the bankers in Iowa. For the twelve-month period ending July 1, farmland values were up 11 percent in Indiana, 10 percent in Michigan and Wisconsin, and a more modest 7 percent in Illinois and Iowa.

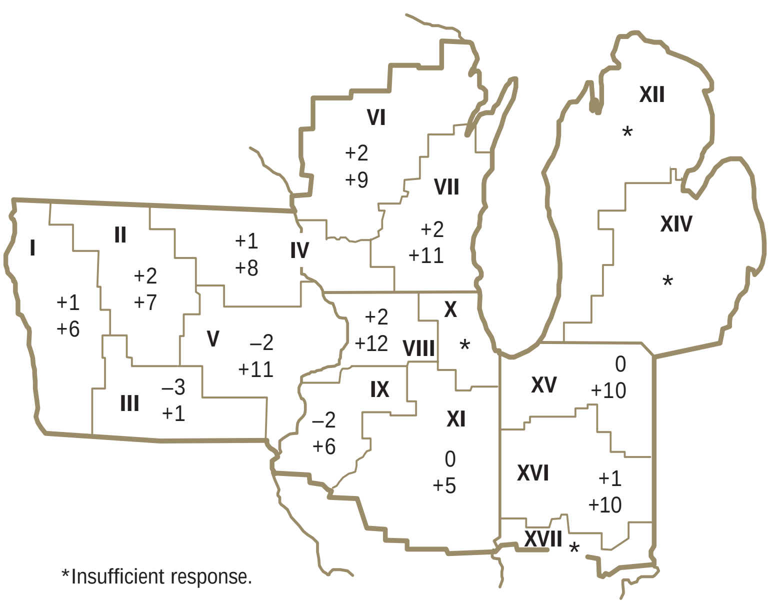
Several factors contributed to the slowing in the rate of increase in farmland values. The income outlook for many District farmers has worsened. Lower commodity prices are expected to cause net farm income to fall this year and a recovery is unlikely next year. Corn and soybean prices have been pulled lower by lackluster demand and the potential for a large fall harvest. Foreign sales—an important swing factor in grain markets—have been sluggish. The export prospects of bulk commodities have further deteriorated as the extent of the financial problems afflicting many Asian nations have become more obvious. Livestock prices are also under considerable pressure from large current and prospective supplies of red meat and poultry. Moreover, the decline in the value of hog and grain inventories has an adverse impact on farmers' balance sheets that acts as an additinal drag on capital spending.

Further complicating the situation, concerns over the change in the farm "safety net" stemming from the 1996 farm legislation have been brought to the forefront by the drought in a few southern states and the low grain prices. These concerns may have further tempered buyers' optimism, despite the fact that subsidy

Percent change in dollar value of "good" farmland

Top: April 1, 1998 to July 1, 1998
Bottom: July 1, 1997 to July 1, 1998

	April 1, 1998 to July 1, 1998	July 1, 1997 to July 1, 1998
Illinois	0	+7
Indiana	+1	+11
Iowa	–1	+7
Michigan	+2	+10
Wisconsin	+2	+10
Seventh District	0	+8



*Insufficient response.

payments are still being made and will continue through 2002. In addition, recent media reports of expected rail transportation problems this fall and the specter of grain stored on the ground have also dimmed expectations. Furthermore, the possibility that a significant amount of corn will be released from the government loan program this fall suggests that there may be even more pressure on corn prices in the near term. Reflecting this environment, fewer District agricultural bankers expect gains in farmland values in the near future. Only 16 percent anticipate an upward trend in the third quarter, about half the number of three months earlier. Two thirds of the respondents believe that farmland values will be flat.

The changing outlook did not diminish the demand for new nonreal estate farm loans during the second quarter. About 42 percent of the surveyed bankers indicated that loan demand was up from the prior year, while 15 percent stated there had been a decline. The remaining 43 percent stated there was no change from last year. The pattern of stronger year-over-year gains in Illinois and Iowa (relative to other District states) continued to hold from the prior survey. About half the respondents in these two states saw an increase in loan demand from last year, while less than a tenth experienced a decline. In contrast, loan demand appeared to moderate in Indiana.

The strength in loan demand is partly attributable to the expansion of the pork sector in District states. A report released by the U.S. Department of Agriculture at the end of June indicated that the pace of expansion in hog numbers in Illinois, Indiana, and Iowa exceeded that for the U.S. as a whole. However, part of the increase in loan demand in District states stems from slower repayments and an increase in requests to renew or extend existing loans. While a large proportion of the surveyed bankers indicated the pace of loan repayments was steady relative to a year earlier, nearly all the rest believed that a decline had occurred. The measure of loan repayments (see table) came in at 74, which reflects 31 percent of the respondents who saw a decline and 4 percent who noted an increase. About two thirds believed the rate of farm loan repayments to be unchanged from a year ago. Continuing the pattern of the previous survey, the most significant deterioration in loan repayments occurred in Illinois and Iowa. Approximately half of the respondents in Iowa indicated a decline, compared to a third in Illinois. The survey also showed a stronger tendency towards requests for loan renewals and extensions. About a third of the bankers reported an increase, while nearly all the rest indicated there was no change from a year earlier. The largest increase in these requests occurred in Iowa and Illinois. It is likely that some of this increase in extensions and renewals simply reflects the reluctance of farmers to sell grain in the face of declining prices.

Liquidity tightened at District agricultural banks during the second quarter. The average loan-to-deposit ratio for all respondents edged higher to reach 72.7 percent as of July 1. Among the individual District states, the ratio ranged from a low of 65.5 percent in Illinois to a high of 83 percent in Michigan. In four states, the mean loan-to-deposit ratio was still below the desired level reported by the bankers. However, lending—relative to deposits—was slightly higher than the desired level in Michigan.

The relatively high lending levels of recent months would normally be expected to dampen the flow of loanable funds from commercial banks to agriculture. However, the amount of funds available for nonreal estate farm loans was quite stable relative to a year earlier. Over 70 percent of the respondents indicated that fund availability was unchanged from a year earlier, while the remainder were nearly evenly split between an increase and a decline. It may be that the availability of funds from non-deposit sources such as the Federal Home Loan Bank and the Federal Agriculture Mortgage Corporation may make the loan-to-deposit ratio less meaningful as a true measure of liquidity than in the past. There was little variation in fund availability across District states, though funding growth for agricultural loans appeared to be relatively stronger in Indiana.

The interest rates charged by agricultural banks on new farm loans as of July 1 showed little change from three months earlier. The average rates for operating loans and real estate loans came in at 9.54 percent and 8.52 percent, respectively. The operating loan rate was down 18 basis points from a year earlier, while the real estate rate was 31 basis points below the year-earlier level. Among the individual District states, the operating loan rate ranged from a low of 9.24 percent in Illinois to a high of 10.26 percent in Michigan, and the real estate loan rate ranged from a low of 8.36 percent in Illinois and Iowa to a high of 9.24 percent in Michigan.

The adversity experienced by the farm economy will likely be translated into problems within the banks' loan portfolios. Yet the seriousness of these problems is difficult to judge at the present time. The bankers reported that, on average, 86 percent of their loan portfolios are experiencing no significant repay-

Credit conditions at Seventh District agricultural banks

	Loan demand	Fund availability	Loan repayment rates	Average loan-to-deposit ratio[1]	Interest rates on farm loans: Operating loans[1]	Feeder cattle[1]	Real estate[1]
	(index)[2]	(index)[2]	(index)[2]	(percent)	(percent)	(percent)	(percent)
1994							
Jan-Mar	136	121	94	59.9	8.52	8.48	7.97
Apr-June	139	107	90	62.5	8.98	8.95	8.48
July-Sept	132	96	94	64.5	9.38	9.30	8.86
Oct-Dec	112	102	111	63.8	9.99	9.93	9.48
1995							
Jan-Mar	122	96	98	64.8	10.33	10.26	9.68
Apr-June	124	104	93	66.1	10.24	10.20	9.64
July-Sept	123	104	98	67.3	10.16	10.14	9.27
Oct-Dec	111	123	119	64.9	9.89	9.88	8.93
1996							
Jan-Mar	125	125	117	65.0	9.62	9.63	8.66
Apr-June	116	114	108	65.8	9.69	9.69	8.81
July-Sept	122	113	112	68.2	9.70	9.68	8.80
Oct-Dec	122	110	94	67.6	9.64	9.61	8.73
1997							
Jan-Mar	134	110	105	67.6	9.71	9.65	8.77
Apr-June	134	97	94	69.7	9.72	9.68	8.83
July-Sept	131	97	93	70.2	9.71	9.69	8.76
Oct-Dec	120	109	95	70.7	9.65	9.63	8.69
1998							
Jan-Mar	134	113	84	70.6	9.52	9.51	8.50
Apr-June	127	102	74	72.7	9.54	9.55	8.52

[1]At end of period.

[2]Bankers responded to each item by indicating whether conditions during the current quarter were higher, lower, or the same as in the year-earlier period. The index numbers are computed by subtracting the percent of bankers that responded "lower" from the percent that responded "higher" and adding 100.

ment problems. This is comparable to the 88 percent reported last year and the 87 percent reported two years ago. However, averages can mask a change in the underlying distribution. Specifically, the number of banks that cited the existence of either major or serious repayment problems increased from a year earlier. About 26 percent indicated that at least some of their borrowers were experiencing major or severe repayment problems, an increase from the 20 percent that reported such problems last year.

Commercial banks remain by far the most important providers of credit to production agriculture. Data from the U.S. Department of Agriculture show that commercial banks account for nearly 40 percent of all farm lending nationally, compared to 26 percent for the Farm Credit System (FCS). Individuals and others account for 23 percent, while life insurance companies hold 6 percent of farm loan volume. Though the FCS maintains a small lead in market share over commercial banks in real estate lending, the banks more than make up for this with approximately half of the nonreal estate farm loan volume.

Despite the strength of commercial banks in farm lending, the surveyed banks indicated that the District farm loan market is very competitive. Half the bankers indicated that the FCS increased its mortgage lending during the second quarter—relative to normal—while over a third stated the FCS had increased its operating lending. Very few respondents indicated the FCS had reduced its lending activity. A large proportion of the respondents stated that input suppliers increased their extension of credit to farmers as well. Finally, a modest increase in the activity of life insurance companies was also noted.

Mike A. Singer

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Federal Reserve Bank of Chicago
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SELECTED AGRICULTURAL ECONOMIC INDICATORS

	Latest period	Value	Percent change from: Prior period	Year ago	Two years ago
Prices received by farmers *(index, 1990–92=100)*	July	102	0.0	–5	–14
Crops *(index, 1990–92=100)*	July	107	0.0	–6	–21
Corn *($ per bu.)*	July	2.11	–7.5	–13	–52
Hay *($ per ton)*	July	88.60	–3.5	–10	–4
Soybeans *($ per bu.)*	July	6.13	–0.3	–18	–20
Wheat *($ per bu.)*	July	2.57	–7.2	–20	–46
Livestock and products *(index, 1990–92=100)*	July	96	–2.0	–3	–6
Barrows and gilts *($ per cwt.)*	July	36.70	–14.8	–39	–38
Steers and heifers *($ per cwt.)*	July	60.70	–5.9	–7	–2
Milk *($ per cwt.)*	July	14.30	2.1	18	–7
Eggs *(¢ per doz.)*	July	58.3	–2.8	–11	–16
Consumer prices *(index, 1982–84=100)*	July	163	0.1	2	4
Food	July	161	0.2	2	5
Production or stocks					
Corn stocks *(mil. bu.)*	June 1	3,039	N.A.	22	77
Soybean stocks *(mil. bu.)*	June 1	593	N.A.	19	–5
Wheat stocks *(mil. bu.)*	June 1	723	N.A.	63	92
Beef production *(bil. lb.)*	June	2.25	5.9	5	3
Pork production *(bil. lb.)*	June	1.44	1.7	10	20
Milk production* *(bil. lb.)*	July	11.3	–0.9	–1	3
Receipts from farm marketings *(mil. dol.)*	April	14,404	–9.3	–3	1
Crops**	April	6,864	–3.2	–1	0
Livestock	April	7,465	–14.5	–5	2
Government payments	April	75	44.2	168	36
Agricultural exports *(mil. dol.)*	May	3,928	–7.6	–10	–19
Corn *(mil. bu.)*	May	113	6.9	–8	–43
Soybeans *(mil. bu.)*	May	28	–23.6	–32	–34
Wheat *(mil. bu.)*	May	70	5.5	40	–13
Farm machinery sales *(units)*					
Tractors, over 40 HP	July	6,918	–9.8	26	55
40 to 100 HP	July	4,381	–21.4	11	30
100 HP or more	July	2,537	20.7	64	130
Combines	July	938	2.2	8	77

N.A. Not applicable
*20 selected states.
**Includes net CCC loans.

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